Accenture Risk & Regulatory Solutions

Risk management for the insurance industry

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Moving beyond compliance to gain a competitive edge and achieve high performance

The economic meltdown that began in 2008 was caused by the faulty assessment of risk by financial services companies and their investors. Identifying and then managing risk is now firmly at the top of the C-suite agenda—especially when it comes to insurers. They are, after all, the ones that assume everybody else's risk—and so their ability to assess their risk effectively, and thus remain able to meet claims, is a cornerstone of the global economy.

For insurers, risk management is literally the difference between success and failure, between mediocre performance and the profitability that is the hallmark of high performance.

Of course, insurers are also subject to the factors that are driving the growing need for sophisticated, integrated risk management solutions across all industry sectors. One set of factors revolves around the nature of business today. As companies increasingly compete globally, so they have to develop complex global operating models. They are also increasingly networked, with the network spreading to include a floating population of consultants, business partners and customers—another universe of risk. Networked business also generates complex flows of information that must be protected and analyzed to support better decision-making.

Another by-product of the Internet economy is the unprecedented power it places in the hands of consumers. They can now compare prices and share experiences—increasing the tendency to switch insurers. The Internet has also connected financial markets as never before, which has had the effect of raising volatility in these markets.

Against this backdrop, insurers must address several risk-related challenges specific to their industry. These include:

Risk taking.

Insurers deliberately assume risks through their underwriters and have to allocate the assets that secure that risk. Managing this asset allocation is vital to ensure an adequate funding of all claims at any time. Clearly, underwriting risks will affect these overall investment decisions. To do all this, an insurer must be able to model its risk in a very sophisticated way. The high-profile failure of insurance companies in the United States not long ago can be attributed in essence to the fact that they assumed risk that they were unable to fund.

Product pricing.

To meet rapidly escalating customer expectations, insurers have to be able to rapidly develop and launch new products into the market. These products must be priced correctly in relation to the risk they represent. Even more important, the insurer needs to have an integrated view of the risk portfolio across the entire underwriting portfolio in order to assign its risk capital accurately. This process must include the charges related to risk capital. Insurers need to be able to model their multifaceted risks and capital charges in order to make sound business decisions.

Customer segmentation.

An insurer's understanding of the risk profile of its products must be matched by the ability to market these products to the right customers. Selling products to the wrong people changes the risk they represent to the insurer—essentially, the subprime housing bubble in the United States was caused by a mis-match between product and customer. Risk management techniques can help underwriters ensure that products are marketed to the correct customers. Key risk indicators are an essential component of these risk management techniques as they allow an insurer to assess the relationship between risk and return. They help management to take decisions based on risk-adjusted customer return profiles.

The need for better risk management is the common thread running through all of these challenges. However, the sophisticated models required for this level of risk management are dependent on the availability of accurate, validated data at the correct level of granularity. For insurers with multiple back-end systems and silos of information, this is easier said than done.

Typically, property and casualty, life and health insurance divisions run their own systems—often more than one. Data definitions and key performance indicators are differently defined across these systems. Similarly, the various parts of the business typically use different tools for the various risk types, and the results are not easily comparable when one attempts to gain an integrated view of the company's total risk profile. Insurers need to create a methodology for aggregating these results in a way that mirrors the way the business is structured, especially as regards the risks that each part of the business has assumed. Only then will management be able to assess accurately the total risk to which the company is exposed.

To this brew one must add the growing body of regulation designed to force companies to manage their risk effectively. Governments and their regulatory authorities have recognized the importance of a healthy insurance industry as a key pillar of a healthy economy. Just as the Basel II Accord attempts to create a regulatory framework for a sound global banking industry, the Solvency II Directive attempts to provide the basis for a solid insurance industry in Europe.

Although there are indications that European insurers are not committing anything like the same amounts of money to complying with Solvency II as their banking peers committed to Basel II initiatives, there are encouraging signs that insurers are looking beyond compliance. Fully 75 percent of companies in an Accenture survey[1] said that they saw a business case for complying with Solvency II. These forward-thinking companies see the benefits of integrating risk management into their overall strategic framework in order to meet the broad challenges described above. The impact of this thinking, initially prompted by Solvency II considerations, will be felt throughout the global insurance industry as overseas subsidiaries of European insurers fall into line with their parent companies, and insurers with no Solvency II obligations move to achieve the competitive edge that integrated risk management brings.

1 The *Accenture Solvency II Market Readiness Survey* was conducted among large European insurers.

The business case for integrated risk management

Risk management that is integrated into a company's core strategy—as mandated by Solvency II—actually increases value by improving cash flow while reducing earnings volatility and the cost of capital. It generates these benefits by:

- **Providing a clear view of company-wide risk.** This integrated view of risk-adjusted performance by business units, products or regions enables better capital allocation and potential diversification.
- **Upgrading operational efficiency.** Through analysis of potential capital investments, risk management offers a better understanding of the risk/return equation in every decision.
- **Improving relations with ratings and regulatory agencies.** Rigorous risk management provides a broader framework for viewing metrics that come under scrutiny.

In this way, then, integrated risk management goes beyond identifying, measuring, monitoring, quantifying and reporting risk. In addition it generates information that influences strategic and operational decisions, directs capital to the most productive uses, and improves the management of product and asset portfolios. The end result: greater investor confidence in the company and thus an increase in overall value.

Case study

Balancing risk and reward

Accenture helped a reinsurer create an integrated risk management framework in the wake of a complex merger, and then a road map to comply with Solvency II.

Risk, and how to assess it accurately, is central to the insurance business as a whole—and particularly to reinsurers, who ultimately assume responsibility for insurers' risks. This mid-sized global reinsurer was formed through the amalgamation of three companies and faced an audit by several of the leading ratings agencies. The group had initiated several risk management initiatives in various geographies, using a variety of methodologies and tools. It asked Accenture to help create an integrated enterprise risk management framework to embed risk management into its business processes, so positioning the company to receive a higher rating from the ratings agencies.

The reinsurer's decision to work with Accenture was based on a long-standing relationship, Accenture's understanding of the industry and its drivers, and its specific skills in risk and project management.

During 2009, Accenture helped this client to develop and implement a framework for enterprise risk management based on recommendations from the ratings agencies. Accenture used the COSO 2[3] Framework to help ensure that the client-specific business practices were in harmony with the recommendations, and used Sharepoint technology to facilitate optimum collaboration with client teams.

The reinsurer also asked the Accenture team to support the implementation of risk-adjusted performance management to align the enterprise risk management framework with the group's strategic goals and risk decision-making process. As a result of this work, the client is able to take its risk profile into account when making decisions.

In 2009, Accenture helped the client to improve its internal control environment to enable better control activities at all levels throughout the group. The internal Control System project was coordinated by Accenture at the group level. During this project, the Accenture team identified and documented the critical processes for the property and casualty, life and investment divisions of the company, as well as support functions such as finance, risk and HR.

During the first six months of 2010, Accenture accompanied its client along the next stage of its risk management journey by helping it prepare for the new Solvency II regulation. Accenture performed a gap analysis to assess the group's readiness in terms of Solvency II directives, developed detailed project plans to bridge each gap, and assessed the financial and human resources needed for each. The second phase involved creating a road map and a program management office to manage the various projects and meet Solvency II requirements before 2012.

3 The Committee of Sponsoring Organizations of the Treadway Commission (COSO) was established to provide guidance on critical aspects of organizational governance, business ethics, internal control, enterprise risk management, fraud and financial reporting.

Accenture's approach to risk management

Accenture's extensive experience in helping companies across all industries manage risk has shown that risk management and strategy come together in three core areas:

Formulate a strategy for risk management.

Strategy has three dimensions: people, process and technology. When it comes to risk management, strategy must outline the company's risk culture, define the rules that will manage the company's exposure to risk, and design the systems to capture, measure, monitor and report risk.

Manage strategic risk.

Risk management uses tools and insights to identify the strategic risks related to the particular industry and the company's strategy. These might include technological changes, new competitors or long-term market price risks. While some short-term risks can be hedged, longer-term strategic risks need a higher order of risk management.

Evolve business strategy.

Risk management must go beyond measuring and protecting existing strategy; it must use tools and metrics to evaluate new strategic options using a controlled risk/return model. This approach gives companies another tool to use in plotting their future courses by evaluating the viability of new opportunities.

Accenture Risk and Regulatory Solutions provides an integrated structure to address risk-related questions throughout the organization. It helps companies understand the risk/reward equation of every decision, going beyond mere compliance to make better capital decisions and ultimately increasing shareholder value. In other words, it can better equip a company to achieve high performance.

A phased approach to risk management

Accenture first helps a client assess its appetite for risk by understanding where it is currently positioned along the risk-maturity continuum. At one end of the continuum is compliance, and at the other, value enhancement. Somewhere in the middle is value protection. In establishing where it currently stands on the continuum, a company makes the first move toward deciding on the culture of risk management it wants to embrace.

Case study

Helping a large global insurer comply with Solvency II reporting

This global insurer is a subsidiary of a large European bank. It thus has to comply both with internal group reporting standards and the Solvency II regulations for insurance. As the insurer had already worked with Accenture on several projects, it recognized Accenture's ability to manage large, complex programs and the multidisciplinary teams it could put together. Accordingly, the insurer called Accenture in to help it assess what needed to be done in terms of Solvency II reporting and its links with market-consistent embedded value (MCEV)[2] and financial reporting. It also needed to define a target operating process that would fulfill the requirements of both internal financial reporting and external risk reporting.

During the first phase of the project, a team drawn from the Accenture Risk Management, Finance & Performance Management and Insurance groups worked closely with the client as well as specialized actuarial and accounting teams to assess processes related to the risk and financial domains, to draw target reporting processes by type of data and to perform a gap analysis. The team also assessed the relative importance of each shortcoming.

Based on the Solvency II directive and advice from the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS), Accenture carefully analyzed the Solvency II reporting content and timescale constraints in the light of the insurer's particular circumstances.

It then produced a detailed breakdown of all elements required for the overall Solvency II reporting (both qualitative and quantitative requirements), and identified the capabilities that needed to be put in place.

Using this analysis, Accenture identified the steps that would need to be taken and supported the client team in defining the road map. It also handled some of the related work streams. With Accenture's help, the client now has a detailed, manageable action plan to comply not only with the group's financial reporting standards, but also with the Solvency II regulations.

2 MCEV is a standard of reporting embedded value that directly affects valuation and profit reporting for life insurance firms.

That done, Accenture recommends a five-step process to establish a risk strategy:

1. Establish strategic guidelines.

Interview high impact stakeholders to find out what the company wants the risk management program to do. Define the role of the risk management team. Will it be an advisor, a controller or a manager, for example? At this stage, insurers should develop a target operating model that integrates risk management.

2. Determine model direction.

This step is about defining the organization's appetite for risk. To do this, it needs to assess the full array of risks—market, credit, underwriting, operational and strategic—and decide how each is going to be measured.

3. Choose the model.

In this step, targets for each risk parameter are set, including key performance indicators to monitor performance. Accenture's approach takes into account the existing risk management tools and processes in place, and integrates both into the total architecture proposed rather than recommending wholesale change. Being software-agnostic, Accenture helps companies select appropriate, complementary software.

4. Perform gap analysis.

Risk management compares an existing risk management function to the desired future state, and maps what has to be done to attain it.

5. Design a strategic road map.

Moving from analysis into implementation and execution, this step outlines the actions needed to turn the strategy into a reality. The insurer establishes a risk management system that is integrated into the decision-making processes and forms an essential part of its governance system.

Accenture Risk and Regulatory Solutions enables a phased approach that can help insurers comply with Solvency II as a first phase, with a longer-term plan for achieving greater value. However, to minimize unnecessary rework, the bigger plan should be articulated up front.

Case study

Going beyond compliance

Accenture helped a major French life insurer create and implement a road map for compliance with Solvency II as part of a wider drive to achieve high performance.

This insurer—the subsidiary of a large European bank—has been working with Accenture on a number of initiatives all aimed at growing its business. These projects include multichannel distribution, excellence in the finance function and business process outsourcing. So when it came time to comply with Solvency II's requirements for a risk management and governance framework, the client elected to rely on Accenture's understanding of its business allied to its track record for managing large projects, its wide range of capabilities across many disciplines, and its understanding of how to make each project contribute to the ultimate goal of high performance.

The first order of business was to conduct a gap analysis and construct a road map and action plans to achieve Solvency II compliance by 2013 in line with the client's principle: "Solvency II, an opportunity to optimize the governance/management processes". During this first phase, Accenture's multidisciplinary team provided project management, data management and functional and IT capabilities to complement its deep understanding of both risk management and Solvency II in particular. Existing and new actuarial models were considered when constructing the overall approach.

A particular challenge was that final Solvency II guidelines have not yet been issued. To accommodate this uncertainty, the framework proposed by Accenture is flexible enough to anticipate the final version of the regulations. In phase two, which is ongoing, Accenture is helping implement the agreed action plans, and is also providing change management support and financial reporting.

With Accenture's help, the client is well on its way toward becoming compliant with Solvency II regulations by 2013. More important in the long run, its enhanced risk management function is better integrated into its overall operations. This development will enable better management and monitoring to safeguard shareholders' funds, and will also integrate risk/reward analysis into decision-making processes generally.

Case study

Creating new tools to meet Solvency II compliance

Accenture helped this major reinsurer implement a complex internal model for Solvency II using innovative technologies—and against a tight deadline.

Accenture worked closely with the reinsurer to define and then implement a complex internal model for Solvency II. This hybrid model used SAS/J2EE-based technologies and new simulation methods, with new data requirements, to replace existing tools based on Excel spreadsheets. This new model had to be integrated into an IT environment that was itself changing.

In the first phase of this challenging project, Accenture helped develop a master plan for Solvency II based on extensive input from users as well as the official regulations and requirements. Accenture developed the Solvency II/ Risk Workflow and operating model specifics of the solution and defined and documented risk user stories as a basis for the later implementation. Accenture then implemented the client's internal model using the Agile software development methodology[4], creating a computing solution for Solvency II that used a multi-processor architecture.

With Accenture's help, the newly implemented model enables the client to run multiple parallel simulations that generate results overnight. Versioning and data plausibility checks were integrated into the solution to comply with Solvency II requirements to allow for full auditability.

4 Agile software development promotes a disciplined project management process characterized by frequent inspection and adaptation, teamwork, self-organization and accountability, to enable rapid delivery of high-quality software, and a business approach that aligns development with customer needs and company goals.

Accenture Risk Management

Accenture has, for the past 30 years, worked closely with many of the world's leading insurers to help them improve their business and capitalize on the opportunities for profitable growth. We work with 34 of the top 40 insurers worldwide and more than half of all North American carriers, providing a broad and deep range of integrated services from management consulting to information technology and business process outsourcing.

We have, for decades, helped clients develop effective, strategic risk management strategies. However, as the global business climate has gradually become more complex and risk management has grown in importance, we have launched a dedicated service line, Accenture Risk Management. This new group brings together all our specialists and proven methodologies and frameworks into a single organization. Our insurance services and capabilities have not changed—Accenture Risk and Regulatory Solutions is just that much more effective when focused within a distinct organization. Accenture Risk Management offers:

A global team of risk management and insurance specialists.

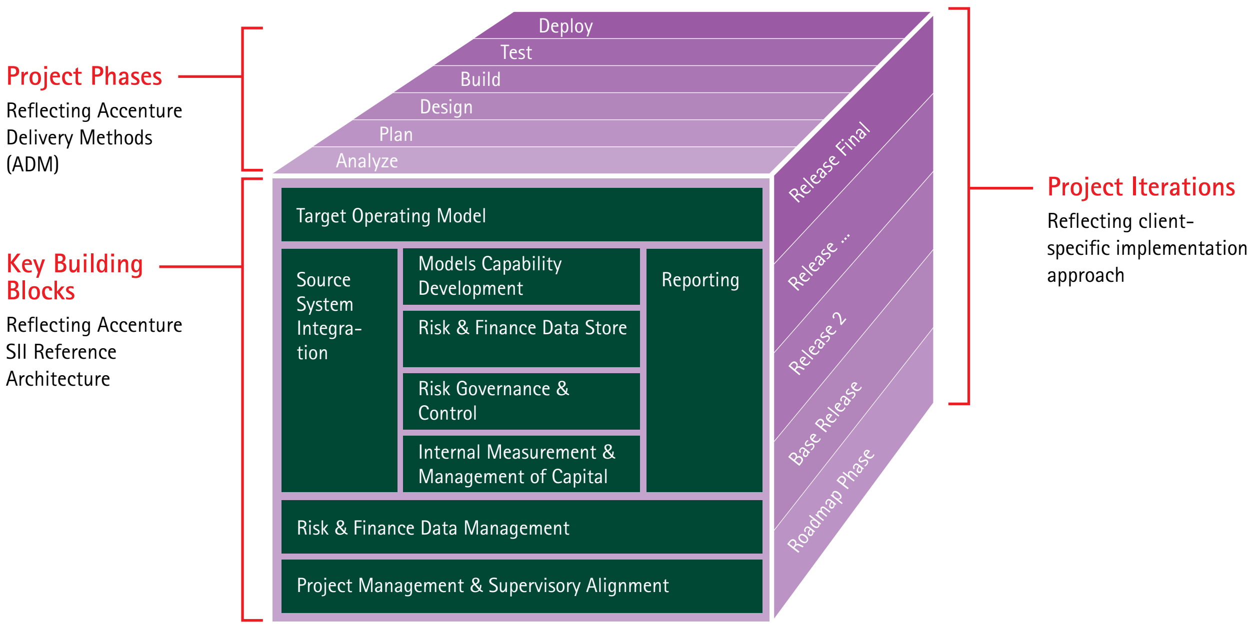
We understand accounting and compliance rules, multinational Generally Accepted Accounting Principles, risk-adjusted performance measures and methods that calculate, aggregate and consolidate risk exposures and capital requirements. We put this together with a globally recognized insurance practice for risk management consulting and implementation that is truly tailored to the insurance industry. Accenture's global network of resources means that we can provide specialized knowledge to clients wherever they are. For example, we can provide a Japanese insurer with information on Solvency II requirements and impacts and even help to develop a localized solution.

Experience.

Accenture has been delivering risk management services to insurers—and the financial services industry generally—for decades. And with more than 35 Solvency II projects on the go and six Solvency II Centers of Excellence in Europe, we have unmatched resources for European insurers with a vision that goes beyond compliance—and a rich mine of experience that is valuable to insurers outside of Europe as well. Accenture has also validated more than 36 tools to help our clients make the all-important selection of software.

Figure 1. The Accenture Risk Management Reference Architecture allows clients to define their specific approach to integrated risk management depending on their ambition level, and to adopt a modular approach to suit their particular circumstances. This diagram shows the Risk Management Reference Architecture mapped to the building blocks needed for implementation.

Accenture's Solvency II Master Planning Framework



Reusable, proven solutions.

Accenture prides itself on its ability to distill its experience into reusable methodologies, frameworks and software—our clients stand tall on the foundations of what has worked before. We offer preconfigured templates, methodologies and proven implementation road maps to integrate the risk function with its specialized tools. These assets reduce your costs, and the risk associated with any transformation.

All these individual components are drawn together into an integrated risk management framework (see Figure 1) to build a risk management competency that truly delivers high performance. We use a phased approach to reduce the time spent on each project.

In all, Accenture Risk Management has the people, global reach, solutions, frameworks and methodologies to help any client use risk management to advance on the journey toward high performance.

For more information on how you can improve your risk management capability, visit www.accenture.com/insurance and click through to "services".

About Accenture

Accenture is a global management consulting, technology services and outsourcing company, with approximately 204,000 people serving clients in more than 120 countries. Combining unparalleled experience, comprehensive capabilities across all industries and business functions, and extensive research on the world's most successful companies, Accenture collaborates with clients to help them become high-performance businesses and governments. The company generated net revenues of US$21.6 billion for the fiscal year ended Aug. 31, 2010. Its home page is www.accenture.com.

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